STATE OF MICHIGAN

IN THE MICHIGAN SUPREME COURT

NATIONAL WINE & SPIRITS, INC., NWS MICHIGAN, INC., and NATIONAL WINE & SPIRITS, L.L.C.,

Plaintiffs-Appellants,

v

STATE OF MICHIGAN,

Defendant-Appellee,

and

MICHIGAN BEER & WINE WHOLESALERS ASSOCIATION,

Intervening Defendant-Appellee.

Supreme Court Docket No. 126121

Court of Appeals Docket No. 243524

Lower Court Case No. 02-13-CZ

126121

DEFENDANT-APPELLEE STATE OF MICHIGAN'S
BRIEF IN OPPOSITION TO APPLICATION FOR LEAVE TO APPEAL

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COUNTER-STATEMENT OF QUESTIONS PRESENTED FOR REVIEW

I. **In early 1997, the Michigan Legislature privatized the State's liquor distribution system. The Michigan Liquor Control Commission appointed Authorized Distribution Agents who are compensated by the State to store and deliver liquor throughout the state. Section 205(3) of the Liquor Control Code (MCL 436.1205) prohibits an Authorized Distribution Agent who is already, or subsequently becomes, a wine wholesaler from selling a brand of wine in a particular territory where a wholesaler is already selling that brand unless such marketing was occurring prior to September 24, 1996. The legislature enacted Section 205(3) to preserve an orderly and stable wine distribution system in the state. Where such regulation does not discriminate against out-of-state entities and implicates the state's core powers under the Twenty-First Amendment to the United States Constitution, does the legislation violate the "dormant" Commerce Clause?**

The Court of Appeals answered: "No"

The circuit court answered: "No"

Appellee State of Michigan answers: "No"

Appellants answer: "Yes"

II. **The legislature enacted Section 205(3) of the Liquor Control Code (MCL 436.1205) to preserve an orderly and stable three-tier alcohol distribution system in the state. The prohibition against "dualing" has a legitimate purpose and rationally serves that purpose. Does this regulation violate the Equal Protection Clauses of the Michigan and United State Constitution?**

The Court of Appeals answered: "No"

The circuit court answered: "No"

Appellee State of Michigan answers: "No"

Appellants answer: "Yes"

COUNTER-STATEMENT OF JUDGMENT APPEALED FROM, GROUNDS, AND RELIEF SOUGHT

. Appellants are seeking leave to appeal from an Opinion of the Court of Appeals dated March 25, 2004, (attached as Exhibit B) that affirmed the circuit court's order granting Appellees' Joint Motion for Summary Disposition, which dismissed this case.

Appellants have not met the requirements of MCR 7.302(B) which sets forth the grounds which must be shown in an Application for Leave to Appeal to this Court. Appellants have not adequately shown that the issue involves a substantial question as to the validity of a legislative act, that the issue has significant public interest, or that the issue involves legal principles of major significance to the State's jurisprudence.

Finally, Appellants have not shown that the decision of the Court of Appeals is clearly erroneous and will cause material injustice or that the decision conflicts with a Supreme Court decision or another decision of the Court of Appeals.

INTRODUCTION

The Court of Appeals' and the circuit court's decisions are consistent with well-established legal authority. Appellants' application should be denied.

Appellants claim that the challenged statute, MCL 436.1205, (Section 205(3)), discriminates against interstate commerce and, therefore, violates the "dormant" Commerce Clause. However, that erroneous contention was rejected by the circuit court and Court of Appeals. As both lower courts recognized, as a threshold matter this case does not even present a Commerce Clause issue. The portion of the circuit court's opinion that Appellants fail to cite stated:

> Now, I understand the Plaintiff's [Appellants'] argument, that because they were not participating at the cut off date they became forever ineligible to be grandfathered, and that they are an out-of-state firm. I understand that argument, and certainly the statute appears to have that effect, but it [the statute] has that effect on any entity, any institution, any company that would have been in the same position as the Plaintiff. **It doesn't single out the Plaintiff and it doesn't single out out-of-state companies**.
>
> * * *
>
> **The statute is facially neutral. The statute does not on its own terms discriminate in any way between out-of-state and in-state entities**. August 14, 2002, Trial Tr., pp 18-20. (Emphasis supplied.) (attached as Exhibit 2 to Appellants' Brief).

The Court of Appeals reached the same conclusion, when it stated:

> **MCL 436.1205(3) does not discriminate against out-of-state economic interests.** The statute is but one provision of a comprehensive system that regulates the flow of all liquor into and within the state. MCL 436.1205(3) applies to both out-of-state and in-state ADAs. Plaintiffs assert that defendant inserted the date in the statute to discriminate against out-of-state ADA/wholesalers because it "knew" that before that date all ADA/wholesalers were in-state entities. But plaintiffs present no evidence of the Legislature's intent, instead they rely on mere speculation.
>
> * * *

As discussed above, the statute contains a legitimate grandfather clause. Defendant asserts the date in the statute had to be before the effective date because if it was not, ADAs and wholesalers would have had a window of time to acquire licenses and/or obtain dualing agreements necessary to gain the unfair advantage that the statute sought to prevent. The reason it allowed already dualing wholesalers to continue to dual after they became ADAs is that they had already entered dualing agreements and defendant did not wish to take this pre-existing right away. "The fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce." *Exxon Corp v Governor of Maryland*, 437 US 117, 126; 98 S Ct 2207; 57 L Ed 91 (1978).

* * *

Our next determination is whether the statute regulates evenhandedly with only incidental effects an interstate commerce. We conclude that plaintiffs have failed to establish that the statute has even an incidental effect on interstate commerce, i.e., "the interstate flow of articles of commerce."

* * *

Thus, we discern no indication that the statute prohibits the flow of interstate goods, places an added cost on them or distinguishes between them in the market. The Commerce Clause "protects the interstate market, not particular interstate firm, from prohibitive or burdensome regulations." *Exxon, supra* at 217-218.

The fact that the statute prohibits plaintiffs from dualing does not implicate the Commerce Clause. Therefore, the circuit court did not err in granting defendant's motion for summary disposition of plaintiffs' Commerce Clause claim. (Emphasis supplied.)

The opinion in *Heald v Engler*, 342 F3d 517 (6th Cir, 2003) which Appellants cite as "controlling" authority bears no factual relationship to issues raised in this case and certainly is not "controlling."[1] *Heald* dealt with the State's right to prohibit out-of-state wineries from bypassing Michigan's three-tier alcohol distribution system by directly shipping product to Michigan consumers. Because Michigan wineries are allowed to deliver product to Michigan consumers (as a privilege of the winery license) the *Heald* court found facial discrimination and

[1] Appellants made this same argument to the Court of Appeals.

ruled that the perceived different treatment of in-state wineries and out-of-state wineries violated the Commerce Clause under a "strict scrutiny" test. The instant case does not deal with importation of alcoholic beverages, but rather deals with Michigan's right to structure its in-state alcohol beverage distribution system -- a right that is clearly within Michigan's traditional "police powers" and Twenty-First Amendment authority.

The *Heald* opinion was wrongly decided. As discussed below, *Heald* is in direct conflict with the express language of the Twenty-First Amendment, a long line of Supreme Court authority and the Seventh Circuit Court of Appeals' decision in *Bridenbaugh v Freeman Wilson,* 227 F2d 848 (7th Cir, 2000) cert den, 532 US 1082 (2001). Most recently, *Heald's* reasoning was rejected by the Second Circuit Court of Appeals. See *Swedenburg v Kelly,* 358 F3d 223 (2nd Cir, 2004) ("The Twenty-First Amendment is unequaled in our constitutional experience – it repeals one constitutional provision and creates an exception to another [i.e. the Commerce Clause]. The Amendment was not a narrow legislative delegation of federal authority; it was the will of the nation speaking through its constitutional process. The amendment brought an end to prohibition while reaffirming the state's power to control the delivery or use of alcohol within their borders.") Appellants fail to mention any of the conflicting authority that correctly contradicts *Heald.* Finally, the United States Supreme Court granted Michigan's Petition for Writ of Certiorari in *Heald* on May 24, 2004.

Similarly, Appellants' Equal Protection Clause claim is without merit. As both the circuit court and the Court of Appeals recognized, Section 205(3) addresses a "well established" state interest in maintaining a *viable* three-tier distribution system for alcoholic beverages, a system that has been in place since the repeal of Prohibition to serve the State's interest in ensuring tax collection, maintaining orderly markets and avoiding sales to minors. See Opinion of Court of

Appeals, p 5 where it stated "[i]t is well-established that preserving an orderly and stable three-tiered alcohol distribution system which allows some competition is a legitimate government interest". As recognized by both lower courts, Section 205(3) is rationally related to that "well established" state interest and Section 205(3) rationally accomplishes the State's interest in distribution of spirits (liquor) through ADAs in a manner that does not destroy the longstanding wine distribution system.

Simply put, the well-reasoned Court of Appeals and circuit court decisions are correct. There is no Commerce Clause issue present in this case because there is no discrimination, let alone a violation of the "dormant" Commerce Clause. Similarly, there is no equal protection violation because the statute is rationally related to a legitimate state purpose - the exercise of regulatory authority over a product referenced in both the Michigan Constitution and the U.S. Constitution.

COUNTER STATEMENT OF PROCEEDINGS AND FACTS

Rather than give an unbiased presentation of the lower court record, Appellants give a lopsided rendition of their opinions and a very selective citation to the record.[2] Appellee, State of Michigan, therefore, submits the following Counter-Statement of Facts.

Appellee State of Michigan, through its Legislature and through the Liquor Control Commission, exercises complete control over alcoholic beverage traffic within the State. See Mich Const 1963, art IV, § 40. The Michigan Liquor Control Code provides at MCL 436.1201(2) that, "except as otherwise provided in this act, the Commission shall have the sole right, power and duty to control the alcohol beverage traffic and traffic in other alcoholic liquor within this state including the manufacture, importation, possession, transportation and sale thereof."

Appellant National Wine & Spirits, Inc., is an Indiana corporation with its principal place of business in Indianapolis, Indiana. (Appellants' Complaint, ¶ 1). Appellant NWS Michigan, Inc. is a wholly owned subsidiary of National Wine & Spirits, Inc. and became a Michigan corporation on October 21, 1996. (Appellants' Complaint, ¶¶ 2 and 3).

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[2] An example of this can be seen in footnote 5 at page 10 of Appellants' brief, where it claims that "dualing" of wine wholesalers is the "norm" in Michigan. There is no citation to the lower court record for support of that contention – which, in fact, is wrong. *See* Lashbrook Aff., attached hereto as Exhibit A, ¶ 7, which was introduced into the circuit court record by Appellee Michigan Beer & Wine Wholesalers Association. Other examples can be seen on page 6 of Appellants' brief, where it states that it is "likely" that "in-state ADAs" "encouraged the Legislature to discriminate against NWS's" which is obviously refuted by the fact that NWS became an ADA immediately with the creation of that position and NWS did not ever attempt to become a wine wholesaler until 1999. More importantly, there is not any admissible evidence in the record to support this type of allegation, which both the circuit court and Court of Appeals recognized to be mere "speculation."

The Liquor Control Commission appointed NWS Michigan, Inc. an Authorized Distribution Agent (ADA) MCL 436.1105(3) to store and deliver spirits (liquor) for the State of Michigan on or about December 22, 1996. (Appellants' Complaint, paragraph 3). Appellant National Wine & Spirits, L.L.C. ("NWS") is also a wholly owned subsidiary of National Wine & Spirits, Inc. and became a Michigan corporation on December 21, 1998. National Wine & Spirits, L.L.C. became a licensed wine wholesaler in Michigan on or about November 12, 1999. (Appellants' Complaint, paragraphs 4 and 5).

Section 205(3) of the Liquor Control Code provides at MCL 436.1205(3):

> An authorized distribution agent shall not have a direct or indirect interest in a supplier of spirits or in a retailer. A supplier of spirits or a retailer shall not have a direct or indirect interest in an authorized distribution agent. An authorized distribution agent shall not hold title to spirits. **After September 24, 1996, an authorized distribution agent** or an applicant to become an authorized distribution agent **who directly or indirectly becomes licensed subsequently as a wholesaler shall not be appointed to sell a brand of wine in a county or part of a county for which a wholesaler has been appointed to sell that brand under an agreement required by this act.** A wholesaler who directly or indirectly becomes an authorized distribution agent shall not sell or be appointed to sell a brand of wine to a retailer in a county or part of a county for which another wholesaler has been appointed to sell that brand under an agreement required by this act, unless that wholesaler was appointed to sell and was actively selling that brand to retailers in that county or part of that county prior to September 24, 1996, or unless the sale and appointment is the result of an acquisition, purchase or merger with the existing wholesaler who was selling that brand to a retailer in that county or part of that county prior to September 24, 1996. (Emphasis supplied.)

The Code clearly and unambiguously prohibits an ADA (such as NWS Michigan, Inc.) who indirectly becomes licensed as a wholesaler (such as National Wine & Spirits, L.L.C.) from selling or distributing wine to retailers in a county or part of a county where that brand of wine is already being sold or distributed by another wholesaler under a lawful agreement with a supplier,

a situation commonly referred to as a "dual" or "dualing", unless that brand was being sold or distributed by the ADA/wholesaler on or before September 24, 1996.

The restrictions in Section 205(3) were first enacted in 1996 PA 440 which took immediate effect on December 19, 1996. Appellant NWS Michigan, Inc. became an ADA on December 22, 1996. NWS Michigan, Inc. entered the Michigan market knowing that no ADA/wholesaler would be able to distribute a particular brand of wine in an area where it was not already selling that brand on September 24, 1996 if another wholesaler was already distributing that brand in that territory as of that date. September 24, 1996 was the operative date set forth in the legislation because that was the date an amendment was introduced that for the first time dealt with an ADA's ability to also become a wholesaler. (*See* discussion below).

Nearly six years later, in 2002, Appellants filed an action in Ingham County Circuit Court challenging the constitutionality of Section 205(3) of the Liquor Control Code.

Appellants first argued below that Section 205(3) is unconstitutional on its face because it denies them equal protection of the law under the Michigan and United States Constitutions. The circuit court denied Appellants' Motion for Summary Disposition on their equal protection claim finding that the legislature had a legitimate purpose in enacting Section 205(3), the preservation of an orderly and stable wholesale wine distribution system which furthers the state's interest. The court further determined that the classifications set forth in Section 205(3) rationally serve that purpose. An order granting summary disposition to Appellee on that claim was subsequently entered May 28, 2002.

Appellees then filed a Joint Motion for Summary Disposition on Appellants' claim that Section 205(3) violates the "dormant" Commerce Clause of the United States Constitution. The circuit court granted Appellees' Motion on August 14, 2002. The court held that the statute's

regulation of Michigan's wine distribution system implicates core powers reserved to the states by the Twenty-First Amendment to the United States Constitution and that Section 205(3) does not violate the Commerce Clause. Importantly, the circuit court held that Section 205(3) does not discriminate against interstate commerce or out-of-state entities on its face or in its application.

Appellants filed a timely Claim of Appeal with the Court of Appeals.

Following oral argument, the Court of Appeals issued a unanimous unpublished per curium opinion on March 25, 2004, a copy of which is attached as Exhibit B. Appellants then filed their Application for leave to appeal.

ARGUMENT

I. Background to understanding the State's distribution scheme, and Michigan's statutory scheme.

A. Introduction.

As noted, NWS is a very large multi-state distributor of wines and spirits.[3] NWS implicitly concedes that it could have become a wholesaler of wine in Michigan prior to 1996 (and the privatization law) if it had so chosen, just as it voluntarily chose to become a wine wholesaler in 1999.[4] NWS also implicitly acknowledges that it voluntarily chose to become an ADA in Michigan in 1996, knowing the limitations on ADAs and wholesalers in Michigan. NWS even concedes that its advice was sought on how this system should work because of its "expertise."

As a large multi-state distributor of spirits and a sophisticated entity dealing in alcoholic beverages, NWS had to know that it was entering a highly-regulated industry where the

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[3] NWS admitted that in the last five years (i.e. prior to filing the Complaint) as an ADA, it had distributed 13 million cases of spirits in Michigan. Therefore, NWS has already earned close to $100 million on its alleged $25 million investment since ADAs are paid $7.48 per case by the State and suppliers. *See* NWS Brief in Opposition to Defendants' Joint Motion for Summary Disposition (court file), p 4, (where NWS states it has distributed 13 million cases of spirits), and Lashbrook Aff., ¶ 13 (where it is explained that ADAs receive a minimum of $7.48 per case). Since that time, presumably NWS's income as a state supported ADA has continued to grow.

[4] Nowhere did NWS allege in the circuit court that it could *not* have become a wine wholesaler ***before*** 1996. NWS tries to disguise that fact on appeal by baldly asserting that the one-year residency required to get a wholesaler license is unconstitutional – but neglects to tell this Court that the constitutionality of the residency requirement is *not* at issue in this case. NWS also neglects to mention that NWS did not seek a ruling on the constitutionality of that requirement and that the circuit court did not rule on that issue (since it was not asked to do so). Therefore, this is not even an issue. *See Swickard v Wayne Co Medical Examiner*, 438 Mich 536 (1991) (issues not decided by the circuit court were not present for appeal). The fact of the matter is that NWS could become a wine wholesaler whenever it wanted to even well before 1996, but NWS decided not to. Therefore, NWS (to the extent that the parent company is not a Michigan resident) is no differently affected by Section 205(3) than any resident of Michigan.

Michigan Legislature (as in most other states) puts numerous regulatory burdens and limitations on licensees in order to protect the State's interests in the use and distribution of alcohol, collection of taxes, promotion of temperance, and maintenance of an orderly distribution system.

The affidavit[5] of Michael J. Lashbrook, President of MB&WWA, gives an explanation of the subject matter at issue here, a background of the legislation, how ADAs are paid by the State and the obvious goals behind Section 205(3). The Affidavit of Nicholas Pavona,[6] Vice President of Classic Wines, Ltd., discusses the dire effect on non-ADA wine wholesalers such as Classic Wines, Ltd., if NWS were to prevail and the legitimate legislative distribution framework established by Section 205(3) were to be undone.[7]

B. Michigan's licensed three-tier alcohol distribution system.

The need for regulation of alcohol traffic is of such paramount interest to Michigan that the Michigan Constitution of 1963, article IV, § 40, delegates to the Legislature, acting through the Liquor Control Commission (the "Commission"), "complete control of the alcoholic beverage traffic within this state." Michigan's right to control distribution (and importation and transportation) of alcoholic beverages within the State is also confirmed by the Twenty-First Amendment of the United States Constitution, which provides in section 2 that "[t]he transportation or importation into any state, territory, or possession of the United States for

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[5] This affidavit was attached to MB&WWA's response to NWS's Motion for Summary Disposition and Request for Summary Disposition pursuant to MCR 2.116(I) (*see* court file.) For the Court's convenience, it is also attached hereto as Exhibit A.

[6] This affidavit was attached to MB&WWA's response to NWS's Motion for Summary Disposition and Request for Summary Disposition pursuant to MCR 2.116(I) (*see* court file.) It is attached hereto as Exhibit C.

[7] NWS would apparently like the Court to believe that anyone can become an ADA. That is simply wrong. The State allows spirit manufacturers to select ADAs and the spirit manufacturers have only chosen a few large entities to distribute their spirits on a state-wide basis (or, at least, a large geographic area).

delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." US Const amend XXI, § 2.

As is done in many states, the Code establishes a licensed three-tier (supplier/ wholesaler/retailer) system for the distribution of wine. MCL 436.1305 (which establishes the relationship between wine suppliers and wine wholesalers) enunciates the long-standing State policy to have a strong and viable three-tier distribution system for wine. It provides, in part:

> "Regulation in this area [i.e., distribution of wine] is considered necessary for the following reasons:
>
> (a) To maintain stability and healthy competition in the wine industry in this state.
>
> (b) To promote and maintain a sound, stable, and viable 3-tier distribution system of wine to the public.
>
> (c) To recognize the marketing distinctions between beer and wine.
>
> (d) To promote the public health, safety, and welfare."

Michigan's licensed three-tier distribution system of alcoholic beverages dates back to shortly after the repeal of Prohibition. *See, e.g.,* MCL 436.1201 and "Historical and Statutory Note" thereto. Among other things, the distribution scheme prohibits an entity in one tier from having a direct or indirect interest in an entity in another tier. *See Borman's, Inc v Liquor Control Comm'n*, 37 Mich App 738, 748 (1972) (addressing "anti-tied house" provisions). As part of its statutory distribution system, Michigan has concluded that it is in the interest of its citizens that all sales, delivery and importation of alcoholic beverages into and within Michigan be done through the authority of the Commission or a licensee, such as a wine wholesaler. *See* MCL 436.1203(1). Thus, in Michigan, the only persons who are authorized to distribute alcoholic beverages to Michigan residents are persons licensed by the State or the State itself.

C. Privatization of distribution of spirits.

In 1996, the State decided to "privatize" the distribution of spirits. Prior to the 1996 legislation, the Commission (*i.e.*, the State) had itself warehoused and distributed spirits. With the passage of Senate Bill 1171 in December of 1996, the State went to a different scheme for the warehousing and distribution of spirits and authorized a few ADAs to perform the state-wide warehousing and distribution of spirits that had previously been done by the State. *See* Lashbrook Affidavit, giving the background of this legislation. Under the new privatization scheme, ADAs receive money from the State and/or spirit suppliers for these warehousing and distribution functions which covers the ADA's operating costs and profit. *See* Lashbrook Affidavit. As the Bill that resulted in the privatization went through the legislative process, the Legislature recognized that ADAs would be receiving funds in connection with performing functions which had previously been performed by the State and that this could give ADAs an unfair economic advantage should they also enter into wine wholesaling activities in direct competition with the then-existing non-ADA wine distribution network.

As initially introduced, the privatization legislation would have prohibited a supplier of wine from appointing more than one wine wholesaler for a brand in the same sales area. This concept was rejected by the Administration and Legislature. On September 24, 1996, the Bill was amended to prevent ADAs from being wholesalers and wholesalers from being ADAs. As the legislation made its way through the legislative process, that outright prohibition was deleted; nonetheless, the Legislature still sought to protect the existing wine distribution system from the obvious unfair advantages that would be enjoyed by ADAs who are also wholesalers. Thus, the Legislature prohibited ADAs (who were or would become wholesalers) from becoming "dualed" with wine wholesalers where the ADA was not already authorized to distribute those dualed wine products in sales territories prior to the privatization law and the creation of ADAs. This

limited restriction was to preserve the existing structure for the distribution of wine. It applies to both ADAs who subsequently became wholesalers and wholesalers who subsequently became ADAs. Contrary to Appellants' argument, all ADAs are generally treated the same, although wholesalers who were already dualed with other wholesalers for particular brands in a particular geographic area on or before September 24, 1996, were allowed to continue those already existing distribution rights after becoming an ADA in recognition of the equity (investment) they had created in those particular brands. They were prohibited from any expansion of those "duals" and wholesalers who subsequently became ADAs were prohibited from being appointed as "dualed" wholesalers where they were not dualed on or before September 24, 1996.

Prior to its final enactment, the section that became MCL 436.1205(3) went through many legislative drafts. As a result, it is clear that the Legislature considered and then rejected keeping wholesalers and ADAs separate. But, in allowing ADAs to also become wholesalers, the Legislature decided that anyone who became an ADA would be barred from utilizing that role to gain advantage over wine wholesalers where the ADA/wholesaler was not already "dualed" with a wholesaler prior to September 1996 when the privatization statute was being amended.

As originally introduced, Senate Bill 1171 did not mention the word "wholesaler" in the ADA portion of the bill.[8]

In substitute (S-3) for SB 1171 (as adopted on September 24, 1996), the Legislature inserted a new subsection (4) [in Section 3(3A)] which stated that: "Beginning September 24, 1996, the Commission shall not license an authorized distribution agent as a wholesaler. The

[8] SB 1171 as introduced was attached to MB&WWA's response to NWS's Motion for Summary Disposition and Request for Summary Disposition pursuant to MCR 2.116(I) (see court file.) It is attached hereto as Exhibit D.

Commission shall not appoint or certify a wholesaler as an authorized distribution agent." Clearly, at that point in time, the Legislature was considering keeping wholesalers and ADAs separate.

The enrolled version of Senate Bill 1171 (signed into law by Governor Engler) indicates that the above-quoted language was eliminated by the Legislature.

The final version of SB 1171 (codified at MCL 436.1205(3))[9] specifies that wholesalers can act as ADAs and vice versa, but with specific limitations to protect the long-established wine distribution system – a system that serves the State's interests as determined by the Legislature.[10]

II. Section 205(3) of the Liquor Control Code does not violate the "dormant" Commerce Clause of the United States Constitution.

A. Summary of Argument.

Appellants alleged in Count II of their Complaint that Section 205(3) of the Liquor Control Code violates the "dormant" Commerce Clause of the United States Constitution. That contention was properly rejected by the circuit court and the Court of Appeals. Appellants now raise the same argument in their Application, even though (as found by both lower courts) the statute at issue does not discriminate against interstate commerce. If there is no discrimination, there can be no valid Commerce Clause challenge.

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[9] Enrolled Senate Bill 1171 was attached to MB&WWA's response to NWS's Motion for Summary Disposition and Request for Summary Disposition pursuant to MCR 2.116(I) (*see* court file.) It is attached hereto as Exhibit E.

[10] Had it so desired, the Legislature could have one wholesaler handle the distribution of beer, wine and spirits. However, the Legislature chose a different framework and that is the Legislature's constitutional right.

US Const art I, § 8 authorizes Congress to regulate commerce among the States. The "dormant" Commerce Clause prohibits State laws that unduly burden interstate commerce. *General Motors Corp v Tracy*, 519 US 278, 287; 136 L Ed 2d 761; 117 S Ct 811 (1997).

The "dormant" Commerce Clause challenge must fail for a variety of reasons. First, as found by both lower courts, neither facially nor in practice does Section 205(3) impermissibly discriminate against out-of-state entities.[11] As found by both lower courts, Section 205(3) treats in-state and out-of-state entities alike. Indeed, Appellants (two of whom are actually Michigan corporate entities and subsidiaries of the out-of-state entity) by their own admission have become ADAs and wholesalers. While the Appellants (Michigan businesses) who are ADA/wholesalers have some limitations on their ability to become "dualed" to distribute some products in some geographic areas, those same limitations apply to anyone who is an ADA or a wholesaler, whether a Michigan business or not.[12] That is, should any Michigan wholesaler wish to become an ADA (as did Appellants in 1999), they would be subject to the same regulations to which

[11] Nor can Appellants argue that Section 205(3) has a purpose of favoring Michigan wholesalers who become an ADA since the statute restricts the right of **any** ADA/wholesaler to be "dualed" that would otherwise be available to a non-ADA Michigan wine wholesaler.

[12] As noted, the challenged statute did not give wholesalers who became ADAs in 1996 an advantage they did not have. It merely froze in place (i.e., "grandfathered") certain already-existing distribution rights and actually **limited** future potential distribution rights in the "dualed" context.

Appellants are subject.[13]

Second, even if, as incorrectly argued, there was some minor detriment to interstate commerce, that would still not give rise to a successful Commerce Clause challenge. *See Pike v Bruce Church, Inc*, 397 U S 137, 142 (1970) (Commerce Clause is not implicated by police power regulations which merely have an incidental effect on commerce by burdening but not prohibiting distribution of products.)

What is at issue here is Michigan's right to structure its distribution system for alcoholic beverages. The Twenty-First Amendment gives Michigan the right to structure that distribution system free of Commerce Clause restraints. In fact, well-established United States Supreme Court precedent indicates that the structuring of a State's alcohol beverage distribution system is one of the "core powers" given to the States by the Twenty-First Amendment.
In a similar vein, federal legislation (the Webb-Kenyon Act, 27 USC §122), gives Michigan the right to establish its own laws regarding distribution of alcoholic beverages free of Commerce Clause restraints. See *infra*, pp 30.

B. Appellants do have access to Michigan.

A few facts bear repetition in considering Appellants' Commerce Clause challenge. First, Appellants' argument that Michigan discriminates against out-of-state entities is belied by

[13] It is important to keep in mind that if Appellants were **only** a wholesaler, they could (like any other non-ADA wholesaler in Michigan) be "dualed" for wine anywhere in Michigan (if the wine supplier so agrees). The only reason Appellant National Wine & Spirits, L.L.C. (a Michigan limited liability company wholesaler) cannot become "dualed" is because NWS (its parent company) also chooses to be an ADA. In this regard, NWS is treated the same as any other Michigan entity who voluntarily wants to become an ADA (*i.e.*, they can take on the role of ADA with certain limitations in their distribution rights as a wholesaler in order for the State to maintain a viable three-tier distribution system and in recognition of the fact that DA/wholesalers could overwhelm non-ADA wholesalers by use of their State-generated income from the distribution of spirits).

the allegations in their complaint. In this regard, the complaint at paragraphs 1-5 describes Appellants:

> 1. National Wine & Spirits, Inc. is an Indiana corporation with its principal place of business in Indianapolis, Indiana.
>
> 2. NWS Michigan, Inc. is a wholly owned subsidiary of National Wine & Spirits, Inc.
>
> 3. NWS Michigan, Inc. became incorporated in Michigan on October 21, 1996 and became an Authorized Distribution Agent of sprits for the State of Michigan on or about December 22, 1996.
>
> 4. National Wine & Spirits, L.L.C. is also a wholly owned subsidiary of National Wine & Spirits, Inc.
>
> 5. National Wine & Spirits, L.L.C. became incorporated in Michigan on December 21, 1998 and became a licensed wine wholesaler in the State of Michigan on or about November 12, 1999." Complaint, p 2.

These allegations disclose a number of critical facts. First, only one Appellant (National Wine & Spirits, Inc.) is a foreign corporation; the other Appellants are a Michigan corporation and a Michigan limited liability company (controlled by Indiana-based National Wine & Spirits, Inc.).[14] Second, Appellants have not been denied access to the market. In fact, National Wine & Spirits, Inc. through its subsidiary, NWS Michigan, Inc., is an ADA and through its subsidiary National Wine & Spirits, L.L.C. is a wine wholesaler. Third, Appellant NWS Michigan, Inc. chose to become an ADA knowing that it (like anyone else who decides to become an ADA and then a wholesaler) would be restricted from being "dualed" as a wine wholesaler in certain specific geographic areas for certain specific brands where it was not distributing those brands in those areas prior to September 24, 1996, and another wholesaler was distributing those brands in

[14] As Michigan entities, NWS Michigan, Inc. and National Wine & Spirits, L.L.C. cannot claim they are "out-of-staters" being treated unfairly under the Commerce Clause.

those geographic areas. The same limitation would apply to any other Michigan entity that first becomes an ADA and then chooses to become a wholesaler. That is, NWS has no restrictions placed on it that any other Michigan corporation entering the market as an ADA or wholesaler would face.[15] And, by NWS's own admission, as an ADA (performing what had previously been a State function), it has distributed 13 million cases of spirits and generated income of $100 million on an investment of $25 million.[16]

C. There is no facial discrimination.

Appellants' complaint does not (and cannot) allege that Section 205(3) on its face discriminates against out-of-state businesses. The statute is facially neutral and does not give Michigan residents special privileges or non-Michigan residents' special burdens. Rather, Appellants seem to allege that Section 205(3) in its operation treats out-of-state businesses differently than in-state businesses. However, that allegation does not bear scrutiny because appellants have not alleged that they could not have operated in Michigan as a wine wholesaler prior to September 24, 1996. In fact, they could have done business in Michigan as a wine

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[15] What Appellants are really complaining about is that having decided not to enter the wholesale market until after September 24, 1996, they face certain statutory limitations with regard to being "dualed" for specific brands in specific geographic areas. However, what Appellants fail to acknowledge is that the same limitations would apply to any Michigan resident choosing to enter into this market. If someone wants to become just a wholesaler, there are absolutely no limitations on their right to be "dualed." It is only where someone entering the market wants to be **both** a wholesaler and an ADA that that person will have certain specific limitations placed on them (unless they were "grandfathered" into distribution rights in specific geographic areas for specific brands prior to September 24, 1996, when ADAs were created to take over what had previously been a State function). Certainly, the State has the right to condition its certification requirements for ADAs to protect the three-tier distribution system.

[16] Presumably, since this suit was filed, NWS (which is believed to be the largest ADA in the state) has distributed many millions more cases of spirits and has generated many millions of dollars in income (and profit) as an ADA.

wholesaler prior to that date (just as Appellant National Wine & Spirits, L.L.C. became a wholesaler in 1999).

Section 205(3) cannot be viewed (as Appellants suggest) as giving special advantages to entities which were wholesalers on September 24, 1996 (and who subsequently became ADAs). Rather, a more faithful reading of Section 205(3) is that (except in the limited "grandfather clause" context) it takes away rights wholesalers (who subsequently became ADAs) had prior to the passage of Section 205(3). Wine wholesalers who were in existence as of September 24, 1996 had the right to be appointed as a "dual" anywhere in the State for any brands of wine. However, after September 24, 1996, should any wholesaler in Michigan voluntarily decide to become an ADA, then it would have its rights to be appointed as a "dual" limited to only those specific geographic areas for specific brands where that wholesaler was already distributing products as of September 24, 1996. Therefore, Section 205(3) actually imposes a restriction that did not previously exist on wholesalers operating in Michigan as of September 24, 1996, if they choose to become ADAs. Since the statute restricts the then-existing rights of wholesalers, it cannot be viewed as having as its goal or effect the provision of a special advantage to in-state businesses over out-of-state businesses. The statute on its face is neutral as applied to in-state or out-of-state entities. Moreover, it does not even have a "protectionist" purpose. Rather, the purpose is to effectuate distribution of spirits by private entities without destroying the three-tier wine distribution system so as to foster the State's own interests in the distribution of alcoholic beverages.[17] *See Capital Cities Cable, Inc v Crisp*, 467 US 691, 714 (1984) (A state's interest in

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[17] Obviously, the State has a major interest in maintaining a viable alcoholic beverage distribution system over which it maintains complete control. These concerns deal with such things as accountability of its licensees to make sure taxes are paid, minors are not served, and that the retailer tier has access to products. Indeed, there is probably no other product that faces such a pervasive and all-encompassing regulatory scheme.

prohibiting the diversion of liquor into its territory is supported by a strong presumption of validity and should not be lightly put aside.)

D. Even assuming incorrectly that there was discrimination, it would not violate the Commerce Clause.

Putting aside the Twenty-First Amendment (discussed below), even if, *arguendo*, there is some discriminatory impact in the application of the statute (there is not) there is no Commerce Clause violation. In fact, even where there is a discriminatory purpose (which does not exist here) behind legislation and discriminatory impact, there is no "dormant" Commerce Clause violation where out-of-state entities still have access to the state market. *See Exxon Corp v Governor of Maryland*, 437 US 117; 57 L Ed 2d 91; 98 S Ct 2207 (1978), where a Maryland law prohibited a producer or refiner of petroleum products from operating a retail service station in the state. Since almost all petroleum products sold in Maryland were produced and/or refined out-of-state, the effect of the law was to foreclose out-of-state oil companies from owning service stations to the great detriment of out-of-state companies and to the great benefit of in-state local businesses. In upholding the statutory scheme and finding no Commerce Clause violation, the U.S. Supreme Court stated:

> [T]he Act creates no barriers whatsoever against interstate independent dealers; it does not prohibit the flow of interstate goods, place added cost upon them, or distinguish between in-state and out-of-state companies in the retail market. The absence of any of these factors fully distinguishes this case from those in which a State has been found to have discriminated against interstate commerce. 437 US at 126.

See also Minnesota v Clover Leaf Creamery Co, 449 US 456; 66 L Ed 2d 659; 101 S Ct 715 (1981). (Minnesota law prohibiting sale of milk products in plastic to the benefit of Minnesota producers of paper containers, upheld as merely a minor burden on interstate commerce).

Simply put, under standard "dormant" Commerce Clause analysis, Appellants would lose, because there is no discrimination and even if (for purposes of argument) there were some *de minimus* discrimination, out of state entities still have access to the Michigan market and that is all the Commerce Clause protects; it does not protect individual corporations. See *Exxon*, 437 US at 126-128 ("the fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of the discrimination against interstate commerce" and the Commerce Clause "protects the interstate market, not particular interstate firms, from prohibitive or burdensome regulations").

Finally, the state has the right to exercise its police powers even if that regulation results in some incidental discrimination. *Pike, supra.*

III. The Twenty-First Amendment gives to Michigan control over transportation and importation of alcoholic beverages and the structuring of its alcohol beverage distribution system.

Even assuming incorrectly that the way Michigan chooses to structure its distribution system for spirits and wines has some adverse impact on interstate commerce, the Twenty-First Amendment gives Michigan the right to do so free of Commerce Clause restrictions.

Michigan's right to control distribution, transportation and importation of alcoholic beverages begins with the Twenty-First Amendment of the United States Constitution adopted in 1933. The Twenty-First Amendment did two things. First, it repealed the Eighteenth Amendment, ending prohibition. And, second, it placed control of alcoholic beverages in the hands of the states. Section 2 of the Twenty-First Amendment provides:

> The transportation or importation into any state, territory or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited. [US Const amend XXI, § 2].

The United States Supreme Court has repeatedly recognized and reaffirmed that the Twenty-First Amendment confers a broad grant of authority upon states to regulate commerce in intoxicating liquors within their borders and to structure the distribution system for intoxicating liquors free of Commerce Clause restrictions. See e.g. *State Bd of Equalization v Young's Market Co*, 299 US 59, 63; 81 L Ed 2d 38; 57 S Ct 77 (1936):

> Can it be doubted that a state might establish a monopoly of the manufacture and sale of beer, and either prohibit all competing importation, or discourage importations by laying a heavy import, or channelize desired importations by confining them to a single consignee?[18]

California Retail Liquor Dealers Ass'n v Midcal Aluminum, Inc, 445 US 97, 107-108; 63 L Ed 2d 233; 100 S Ct 937 (1980):

> [E]arly decisions on the Twenty-First Amendment recognized that each State holds great powers over the importation of liquors from other jurisdictions . . . and The Twenty-First Amendment grants the States **virtually complete control over** whether to permit importation or sale of liquor and **how to structure the liquor distribution system**. (Emphasis supplied.)

Hostetter v Idlewild Bon Voyage Liquor Corp, 377 US 324, 333; 12 L Ed 2d 350; 84 S Ct 1293 (1964), recognizing a state's right to "regulate or control the transportation of . . . liquor . . from the time of its entry into the State in order to avoid unlawful diversion into its territory." Additionally, the U.S. Supreme Court noted, "This Court made clear in the early years following adoption of the Twenty-First Amendment that by virtue of its provision a State is totally unconfined by traditional Commerce Clause limitations when it restricts the importation of intoxicants destined for use, distribution, or consumption within its borders." *Id.*, 377 US at 330. *Ziffrin, Inc v Reeves*, 308 US 132, 138; 84 L Ed 128; 60 S Ct 163 (1939):

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[18] In *Young's Market*, the Court upheld a license fee on the importation of beer that would have been unconstitutional under the Commerce Clause, but not the Twenty-First Amendment.

> The Twenty-First Amendment sanctions the right of a State to legislate concerning intoxicating liquors brought from without, unfettered by the Commerce Clause.

Indianapolis Brewing Co v Liquor Control Comm'n, 305 US 391, 394; 83 L Ed 243; 59 S Ct 254 (1939):

> Since the Twenty-First Amendment . . . the right of a state to prohibit or regulate the importation of intoxicating liquor is not limited by the Commerce Clause.[19]

The broad scope of a state's "core power" to regulate intoxicating liquors and structure its alcoholic beverage distribution system was reaffirmed in *North Dakota v United States,* 495 US 423; 109 L Ed 2d 420; 110 S Ct 1986 (1990). The Supreme Court reconfirmed that within "the area of its jurisdiction, the State has 'virtually complete control' of the importation and sale of liquor and the structure of the liquor distribution system." In upholding a North Dakota statute that was challenged as violating the Supremacy Clause, Justice Stevens, for a four-Justice plurality, stated:

> The two North Dakota regulations fall within the core of the State's power under the Twenty-First Amendment. In the interest of promoting temperance, ensuring orderly market conditions, and raising revenue, the State has established a comprehensive system for the distribution of liquor within its borders. That system is unquestionably legitimate. *Id.* at 431-432 (Emphasis supplied.)

Justice Scalia, concurring, stated:

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[19] As a review of the case law will indicate, there are factual situations completely different than those at issue here where a state acting outside of its Twenty-First Amendment "core powers" may violate another provision of the constitution. However, even these cases recognize the limitation put on the Commerce Clause when a state is involved with the importation and delivery of alcohol within its borders. *See, e.g., 44 Liquormart, Inc. v Rhode Island*, 517 US 484, 516; 134 L Ed 2d 711; 116 S Ct 1495 (1996) ("[T]he Twenty-First Amendment limits the effect of the dormant Commerce Clause on a State's regulatory power over the delivery or use of intoxicating beverages within its borders . . ..").

> The Twenty-First Amendment . . . empowers North Dakota to require that all liquor sold for use in the State be purchased from licensed in-state wholesalers. 495 US at 447.[20]

Thus, as recognized by *North Dakota* (and numerous other Supreme Court cases, *supra*), the Twenty-First Amendment controls when a state, *inter alia*, seeks to regulate importation or transportation of alcoholic beverages, seeks to ensure orderly market conditions (*i.e.*, structure its distribution system), or seeks to raise tax revenues. And, as noted in *North Dakota* (Opinion of J. Scalia at 447): States can require that imported alcoholic beverages must pass through the state's licensed three-tier system in the manner prescribed by state law free of Commerce Clause restrictions.

Here, the Twenty-First Amendment gives Michigan the right to distribute spirits (and wines) itself if it so chooses, or to set up a distribution scheme involving ADAs and wine wholesalers and to structure how those entities are allowed to distribute free of any Commerce Clause restrictions that might apply to other products.

IV. Appellants' interpretation of the Twenty-First Amendment as it applies to a state's power to structure its alcohol distribution system is simply wrong.

Appellants want this Court to completely ignore the Twenty-First Amendment and treat alcohol like "cheese" or any other product.[21] Appellants argue that the Commerce Clause

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[20] Four Justices dissented in *North Dakota* on a federal immunity issue, but no Justice disputed that a state could require that imports of alcoholic beverages for state residents go through a licensed wholesaler. *See North Dakota, supra,* 495 US at 448-471.

[20] It must be kept in mind that alcoholic beverages are among the most regulated products and this statutory scheme is one piece of the state's licensed distribution system for alcohol which ensures that the state collects taxes, that minors don't have access to alcohol, and that all levels of the three-tier system comply with state statutes and regulations.

[21] It must be kept in mind that alcoholic beverages are among the most regulated products and this statutory scheme is one piece of the state's licensed distribution system for alcohol which ensures that the state collects taxes, that minors don't have access to alcohol, and that all levels of the three-tier system comply with state statutes and regulations.

trumps the Twenty-First Amendment, and would read out the "core power" analysis recognized in the numerous Supreme Court cases cited by Appellees. In support of their position, Appellants rely primarily upon three Supreme Court decisions: *Hostetter* v *Idlewild Bon Voyage Liquor Corp*, *supra*, *California Retailer Dealers Ass'n* v *Mid-Cal Aluminum*, *supra*, and *Bacchus Imports Ltd* v *Dais*, 468 US 263; 82 L Ed 2d 200; 104 S Ct 3049 (1984), and erroneously contend that these cases reject the "core power" analysis set forth in earlier Supreme Court cases. Appellants now also cite to *Heald v Engler* as "controlling" authority (discussed below at Section 4). However, a close reading of these cases demonstrates that they do not stand for the proposition asserted by Appellants, as they do not deal with a state's "core power" to regulate importation or transportation of alcoholic beverages into the state. Certainly none deals with a state's right to structure the state's alcoholic beverage distribution system (a "core power").

For example, the *Hostetter* case is easily distinguished on its facts from the instant case, which deals with the structure of a state's alcohol beverage distribution system. The issue addressed In *Hostetter* was whether New York had the power to prohibit the passage of liquor through its territory (under the supervision of the United States Bureau of Customs acting under federal law) for delivery to consumers in foreign countries. Since actual delivery and use of the alcoholic beverages was in foreign countries, and not New York, the statute ran afoul of the Commerce Clause and was unconstitutional. *Hostetter* is not controlling as to this case, since the Michigan statute challenged here only deals with alcoholic beverages being delivered in Michigan, for sale in Michigan to Michigan residents.

In fact, the *Hostetter* Court (at 377 US at 330-331) cited with approval numerous cases dealing with a state's plenary authority under the Twenty-First Amendment to restrict importation and to regulate the structure of its alcohol beverage distribution system free of

Commerce Clause restraints. With regard to that type of "core power," the *Hostetter* Court stated: "This view of the scope of the Twenty-First Amendment with respect to a State's power to restrict, regulate, or prevent the traffic and distribution of intoxicants within its borders has remained unquestioned." 377 US at 330. The Court at pages 330 and 331, reaffirmed the long line of "core power" authority, which includes the right to structure a state's distribution system, the subject of this lawsuit. *State Board of Equalization* v *Young's Market Co*, *supra*, recognized immediately after the repeal of Prohibition that states could set up monopolies in alcohol beverage distribution and even channel importation of alcohol through a single consignee.

Additionally, *Bacchus Imports LTD v Dias, supra,* also does not support Appellants' attempt to negate the "core power" line of authority. *Bacchus* involved a Hawaii statute which exempted locally produced pineapple wine from Hawaii's excise tax. This legislation was found to economically discriminate against out-of-state liquor, and the Hawaii statute in question was not "designed to promote temperance, or to carry out any other purpose of the Twenty-First Amendment." *Id.*, 468 US at 276 .

Of special note in analyzing *Bacchus* is the fact that Hawaii had acknowledged, prior to the case reaching the United States Supreme Court, that there was a protectionist purpose to the statue, and had "expressly disclaimed any reliance on the Twenty-First Amendment in the court below." *Id.*, 468 US at 274, n 12. It was only at the eleventh hour, when the case was already in the United States Supreme Court, that Hawaii attempted to shield its facially protectionist statute under the guise of the Twenty-First Amendment. The *Bacchus* court found that "because [Hawaii's] tax violates a central tenet of the Commerce Clause, but is not supported by any clear concerns of the twenty-first amendment, we reject the state's belated claim based on the Amendment." *Id.*, 468 US at 276.

Similarly, the facts in *California Retail Liquor Dealers Ass'n* v *Midcal Aluminum, Inc*, *supra*, do not in any way resemble the facts at issue here which involve how Michigan decides to structure its distribution system for alcoholic beverages. *California Retail Liquor* dealt with a state's right to require fair trade contracts (or price schedules), which had the effect of setting prices for that brand for all wholesalers within a given territory and resulted in resale price maintenance by private entities through the state. The Court found this violated the Sherman Antitrust Act.

While the *California Retail Liquor* case held that the price maintenance scheme was not protected from a Commerce Clause challenge, the Court recognized that there are "core power" areas where the Twenty-First Amendment insulates states from the operation of the Commerce Clause. In fact, the *California Retail Liquor* Court stated:

> "These [other Supreme Court] decisions demonstrate that there is no bright line between federal and state powers over liquor. **The Twenty-First Amendment grants the States virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system**. Although States retain substantial discretion to establish **other** liquor regulations, those controls may be subject to the federal commerce power in appropriate situations. The competing state and federal interests can be reconciled only after careful scrutiny of those concerns in a "concrete case." *Hostetter* v *Idlewild Liquor Corp, supra*, at 332. (Emphasis supplied.)

The foregoing quote demonstrates that after *Hostetter*, the United States Supreme Court had not retreated from its earlier decisions that held that a state had "virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system." It is only in establishing other liquor regulations (that do not involve "core powers") that a state might run afoul of the Commerce Clause in a "concrete case."

Clearly, these three cases are factually distinguishable from this case, since this case does not deal with price affirmation, does not allow private parties to set prices, does not involve taxation, and the challenged Michigan Statute does not have extra-territorial effect. Rather, in this case, the statutory scheme involves Michigan's interest in regulating importation and transportation of alcoholic beverages into Michigan and making sure that those alcoholic beverages pass through the State's designated distribution system through licensed persons or persons over whom the State can exercise control. Section 205(3) does not in any way affect the price of wine sold to residents in other states, which is the type of extra-territorial effect which would arguably remove the statute from Twenty-First Amendment protection.

Appellants' contention that cases such as *Hostetter*, *Bacchus* and *California Retail Liquor* overruled or rejected prior Supreme Court authority regarding the scope of a state's right to regulate the importation and transportation of alcoholic beverages and to structure a state's alcohol beverage distribution system is not supported by the cases themselves. Again, a careful reading of *Hostetter* (and the other cases cited by Appellants) indicates that it relied on those earlier Supreme Court cases and reaffirmed those earlier "core power" cases which recognize that in some core areas a state's authority to regulate free of the Commerce Clause is unquestioned. *See, e.g., Hostetter, supra*, 377 US at 330-331.

In fact, the United States Supreme Court has continued to this day to rely upon the earlier cases establishing the "core powers" delegated to the states by the Twenty-First Amendment, that Appellants claim were rejected by *Hostetter* and subsequent cases. *See, e.g.*, *44 Liquormart* v *Rhode Island*, 517 US 484; 134 L Ed 2d 711; 116 S Ct 1495 (1996); *North Dakota* v *United States*, 495 US 423; 109 L Ed 2d 420; 110 S Ct 1986 (1990), and *Capital Cities Cable* v *Crisp*,

467 US 691; 81 L Ed 2d 580; 104 S Ct 2694 (1983). The Supreme Court has not rejected these earlier "core power" cases, and in fact, still cites and relies upon them.

Other recent federal decisions upholding a state's core power authority to structure its alcohol distribution system free of Commerce Clause restraints include: *Bridenbaugh v Freeman-Wilson*, 227 F3d 848 (CA 7, 2000), *cert den*, 532 US 1002 (2001), and *Swedenburg*, *supra*, 358 F3d 223.

V. Plaintiff-Appellants' contention that this case is "controlled" by *Heald v Engler* is meritless.

Appellants' claim that the Sixth Circuit's decision in *Heald, supra,* 342 F3d 517, controls this case. *Heald* is not controlling here because only U.S. Supreme Court authority is controlling on this Court. *Abela v General Motors Corp.,* ____ Mich ___; 677 NW2d 325 (2004). Furthermore, *Heald* is not only distinguishable on its facts - it was wrongly decided.

The reasoning used in *Heald* is inconsistent with U.S. Supreme Court authority on the effect of the Twenty-first Amendment vis-à-vis the Commerce Clause. See e.g. *North Dakota v US*, 495 U.S. 423 (1990). And *Heald* is factually distinguishable from the instant case since it dealt with a State's authority to restrict importation of wines for delivery directly to consumers outside the three-tier distribution system – a different statutory provision than the one at issue here. The holding in *Heald* is still on appeal. The United States Supreme Court granted Michigan's Petition for Writ of Certiorari on May 24, 2004.

Further, the most recent federal appellate court to address the same issue addressed by *Heald* – direct shipping of wine to consumers from outside a state -- has rejected *Heald's* reasoning and is in direct conflict with *Heald.* See *Swedenburg v Kelly*, 358 F3d 223. The recent *Swedenburg* decision (which is not even cited by Appellants) correctly recognizes that the Twenty-First Amendment takes precedence over the Commerce Clause. The *Heald* opinion is

also directly in conflict with The Seventh Circuit's ruling in *Bridenbaugh v Freeman-Wilson*, 227 F.3d 848 (7th Circuit), *cert den*, *Bridenbaugh v Carter*, 121 S Ct 1672 (2002).[22] The *Swedenburg* and *Bridenbaugh* opinions apply the correct Twenty-First Amendment analysis and are consistent with a long line of United States Supreme Court authority.

VI. The Webb-Kenyon Act, 27 USC §122, gives Michigan the right to structure its alcohol distribution system free of any Commerce Clause restraints.

While the lower courts did not need to address this argument (because they found no Commerce Clause violation) there is also controlling federal legislation that demonstrates that the U.S. Congress has ceded to the states the right to regulate alcohol free of any Commerce Clause restriction. The Webb-Kenyon Act, 27 USC § 122 provides, "The shipment or transportation in any manner by any means whatsoever, of any...intoxicating liquor of any kind, from one State...into any other State...in violation of any law of such State...is hereby prohibited." *See Clark Distilling Co v Western M R Co*, 242 US 311, 324; 61 L Ed 326; 37 S Ct 180 (1917), where the Court noted that the purpose of the Webb-Kenyon Act was:

> [T]o prevent the immunity characteristic of interstate commerce from being used to permit the receipt of liquor through such commerce in States contrary to their laws, and thus in effect afford a means by subterfuge and indirection to set such laws at naught.

The genesis of this federal legislation was *Leisy v Hardin*, 135 US 100; 34 L Ed 128; 10 S Ct 681 (1890) where the Supreme Court declared invalid an Iowa statute regulating the sale of alcoholic beverages which had been shipped from outside the state. In response, Congress enacted the Wilson Act (27 USC § 121), which declared that upon arrival into a state, alcoholic beverages become subject to that state's regulatory scheme in the same manner as alcoholic beverages produced within the state. The constitutionality of the Wilson Act was upheld in *In*

[22] The *Heald* opinion tries to distinguish *Bridenbaugh*, but the statutory scheme at issue in Indiana is identical to that in Michigan and *Heald* and *Bridenbaugh* are in direct conflict.

re: Rahrer, 140 US 545; 35 L Ed 572; 11 S Ct 865 (1891). In *Rhodes v Iowa*, 170 US 412; 42 L Ed 1088; 18 S Ct 664 (1898), the Supreme Court held that although alcoholic beverage products lose their character as items for interstate commerce after their delivery into a state, the Wilson Act did not authorize the laws of a state to be applied to such merchandise while in transit in the state and prior to delivery to a consignee within the state. *See also Vance v W.A. Vandercook Co*, 170 US 438; 42 L Ed 1100; 18 S Ct 674 (1898), where the Supreme Court declared that the Wilson Act did not recognize the right of a state to prevent an individual from ordering alcoholic beverages from outside the state for that individual's own consumption.

Congress reacted to these interpretations in 1913, with the passage of the Webb-Kenyon Act, 27 USC § 122. The intent of the Act is set forth in its title: "An Act Divesting Intoxicating Liquors of Their Interstate Character in Certain Cases." Representative Clayton, Chairman of the House Judiciary Committee, explained the purpose behind the Webb-Kenyon Act when he stated:

> The purpose [of the bill] is to take the protecting arm of the Federal Government, by virtue of the interstate Commerce Clause of the Constitution, from around the illicit dealers in liquors, and is to allow the States which have passed police regulations restricting or forbidding the sale of liquor to better enforce those regulations. 49 Cong Rec H 2864 (Daily Ed, February 8, 1913).

The Supreme Court upheld the validity of the Webb-Kenyon Act in *Clark Distilling Co, supra*, 27 USC § 122.

Subsequently, the Eighteenth Amendment was passed, which brought about Prohibition. With that "experiment" having failed, Congress not only repealed the Eighteenth Amendment, but also specifically provided in the Twenty-First Amendment that the "transportation or importation into any State . . . for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited."

Congress then, to reiterate the point, reenacted the Webb-Kenyon Act without change in 1935, and the US Supreme Court promptly thereafter held that the Twenty-First Amendment "sanctions the right of a state to legislate concerning intoxicating liquors brought from without, unfettered by the Commerce Clause." *Ziffrin, supra,* 308 US at 138. Thus, even if Section 205(3) affected interstate commerce (it does not), it would be free of any Commerce Clause restrictions since the Webb-Kenyon Act authorizes the states to regulate alcohol unhampered by such restrictions.

VII. The Affidavits submitted by NWS in support of its Application should not be considered since they do not comply with the court rules.

In support of its arguments in the circuit court, the Court of Appeals, and before this Court, Appellants attached the affidavits of Gregory Mauloff, Steve Null, and Patrick Anderson. Even a cursory review of those "affidavits" indicate that they do not meet the requirements of MCR 2.116(G)(6) and MCR 2.119(B). Under MCR 2.119(B), affidavits submitted in support of motions for summary disposition, must:

1. Be made on personal knowledge;

2. State with particularity facts admissible as evidence establishing or denying the grounds stated in the motion; and

3. Show affirmatively that the affiant is sworn as a witness, can testify competently to the facts.

A review of the affidavit of Mr. Mauloff (for example) indicates that it makes sweeping generalizations about his "estimate," but does not indicate upon what facts that estimate is made. Appellees believe that Mr. Mauloff's "estimates" and sweeping generalizations (unsupported by any facts) are simply wrong. However, there is no need to become embroiled in a battle of "affidavits" on these points because Michigan has the right, pursuant to the Twenty-First

Amendment, to structure its alcoholic beverage distribution system as it sees fit and the affidavits submitted by Appellants do not meet the requirements of the Court Rules. In fact, the Court Rule was designed to preclude a party from doing exactly what Appellants tried to do in the circuit court – try to persuade a court to consider "evidence" that is not admissible and would not be allowed at trial. Mr. Anderson's and Mr. Nulls affidavits are equally defective and do not comply with the Court Rules and should not be considered.

MCR 2.116(G)(6) provides:

> "Affidavits, depositions, admissions, and documentary evidence offered in support of or in opposition to a motion based on subrule (C)(1)-(7) or (10) shall only be considered to the extent that the content or substance would be admissible as evidence to establish or deny the grounds stated in the motion."

Since the affidavits submitted by NWS did not meet the requirement that they be based upon admissible evidence and facts and are merely inadmissible "opinions" and "estimates," they should not be considered by this Court. Appellees did, in fact, object to these affidavits in the circuit court. *See* Defendants' Joint Reply Brief in Support of Motion for Summary Disposition, pp 12-15. (Court file.)

VIII. Section 205(3) of the Liquor Control code does not violate the Equal Protection Clauses of the Michigan and United States Constitutions.

Appellants argue that the prohibition against "dualing" contained in Section 205 of the Liquor Control Code denies them equal protection of the laws as guaranteed by the United States and Michigan Constitutions, US Const. Am XIV; Const. 1963, art I, § 2. That contention was categorically rejected by both the Court of Appeals and the circuit court.

To begin with, because the legislative distinction at issue does not interfere with a fundamental right or employ a suspect classification, it need only "bear a rational relation to a legitimate state purpose" to satisfy the Constitution. *Western & Southern Life Insurance Co. v*

State Board of Equalization, 451 US 648, 668; 68 L Ed 2d 514; 101 S Ct 2070 (1981). "So long as the Legislature's judgment is supported by a rational or reasonable basis, the choices made and the distinctions drawn are constitutional." *O'Donnell v State Farm Ins.,* 404 Mich 524, 542; 273 NW2d 829 (1979). *Shavers v Attorney General,* 402 Mich 554, 613; 267 NW2d 72 (1978) *cert den sub nom Allstate Ins. Co. v Kelley,* 442 US 934; 61 L Ed 2d 303; 99 S Ct 2869 (1979). Legislative classifications are entitled to a presumption of constitutionality. *New Orleans v Dukes,* 427 US 297, 303; 49 L Ed 2d 511; 96 S Ct 2513(1976). *McDonald v Saginaw Prosecuting Attorney,* 150 Mich App 52, 58; 388 NW2d 301, *lv den* 426 Mich 866 (1986).

The burden of proof is squarely on the challenger, *Eastway v Eisenga*, 420 Mich 410, 420; 362 NW2d 684 (1984):

> The burden is on the person challenging the classification to show that it is without reasonable justification. **The statute will be set aside only if there is not any set of facts which can reasonably be conceived to justify it.** *McAvoy v H B Sherman Co.,* 401 Mich 419, 453; 258 NW2d 414 (1977.) Where the legislative judgment is drawn in question by an equal protection challenge, **a court's inquiry must be restricted to the issue whether any state of facts either known or which could reasonably be assumed affords support for it.** (Emphasis supplied.)

The Equal Protection Clause is not intended to protect against all inequity. Legislative judgments will never be perfect, because of the practical limitations inherent in lawmaking. The Constitution does not require mathematical precision *Dandridge v Williams*, 397 US 471, 485; 25 L Ed 2d 491; 90 S Ct 1153(1970):

> [A] state does not violate the Equal Protection Clause merely because the classifications made by its laws are imperfect. If the classification has "some reasonable basis," it does not offend the Constitution merely because the classification "is not made with mathematical nicety or because in practice it results in some inequity." *Lindsley v Natural Carbonic Gas Co.,* 220 US 61, 78. "**The problems of government are practical ones and may justify, if they do not require, rough accommodations—illogical, it may be and unscientific.**" *Metropolis Theatre Co. v Chicago*, 228 US 61, 68-70. "A statutory

> discrimination will not be set aside if any state of facts reasonably may be conceived to justify it." *McGowan v Maryland*, 366 US 420, 426.

As noted by both the Court of Appeals and the circuit court, a rational basis exists for the legislative classification set forth in Section 205(3) of the Liquor Control Code. Since repeal of Prohibition, Michigan (like many states) operates under a three-tier alcohol distribution regulatory structure, which separates transactions and obligations of manufacturers, wholesalers, and retailers. Manufacturers of alcohol may not also be wholesalers, nor may wholesalers be retailers. This structure protects against the collusion, price-fixing, and monopolization problems that existed before Prohibition. Sections 205, 603, and 609 of the Liquor Control Code, MCL 436.1205; MCL 436.1603 and MCL 436.1609, preclude vertical integration in the alcohol beverage industry. As the Court pointed out in *Traffic Jam & Snug, Inc. v Michigan Liquor Control Commission*, 194 Mich App 640, 642; 487 NW2d 768 (1992) decided under the former Liquor Control Act:

> "Tied house" statutes are aimed at **preventing the integration** of manufacturing, wholesale, warehouse, and retail outlets in the liquor industry. . . .It has been a fear . . . that **economic power at one level** in this four-tiered system (manufacturers, warehouses, wholesalers, and retailers) **could be transferred to another level in order to gain control** at the second level. [*Borman's, Inc. v Liquor Control Comm*, 37 Mich App 738, 746; 195 NW2d 316 (1972)]. (Emphasis supplied.)

Since the repeal of Prohibition, wine wholesalers have operated as the middle tier of the state's three-tier (supplier, wholesaler, retailer) wine distribution system. The wine wholesalers are complying with statutory requirements set forth in the Liquor Control Code, specifically, Section 305 and Section 603.

The restriction on "dualing" set forth in Section 205(3) of the Code does not preclude an ADA from also acting as a wine wholesaler. It merely prevents an ADA who is also licensed as a wine wholesaler from selling a brand of wine in a county or part of a county already serviced

by another wholesaler, if that particular brand was already being sold in that particular geographic area on or before September 24, 1996, by some other wholesaler. ADA's did not exist prior to privatization. Storage and distribution of liquor to retailers were entirely state functions. When the legislature privatized these functions and created ADA's, it recognized that the existing wine distribution market would be jeopardized if an ADA/wholesaler (who was paid an amount of money by the State sufficient to cover operating costs) could also distribute a brand of wine in an area already serviced for that brand by an existing wine wholesaler. The legislature was unwilling to provide an overwhelming State-subsidized advantage to ADA/wholesalers. Therefore, the State put limited restraints on all ADAs as to where they could be "dualed" with non-ADA wholesalers. Had the State not included the limited restrictions set forth in Section 205(3), ADAs/wholesalers would have been able to leverage the reduced operating costs resulting from the State payment to drive the then existing wine wholesalers out of business essentially destroying the "middle-tier" of the state's wine distribution system and concentrating it in the hands of the few ADAs.

The legislature clearly had a rational basis for enacting the restriction in Section 205(3), which applies equally to all ADAs. Section 205(3) prohibits all ADA/Wine Wholesalers, whether in state or out-of-state, from distributing wine in counties already serviced by another wine wholesaler. Moreover, the fact that Appellant National Wine & Spirits, Inc. is an out-of-state company is irrelevant. Appellant National Wine & Spirits, L.L.C., a Michigan corporation, is a wholly owned subsidiary of Appellant National Wine & Spirits, Inc. and is a licensed wine wholesaler in this State. Appellant National Wine & Spirits, Inc. could have obtained a license to wholesale wine in Michigan prior to September 24, 1996 in precisely the same manner it did subsequent to that date. As a result of being licensed as a wine wholesaler, Appellant National

Wine & Spirits, L.L.C., can currently distribute a brand of wine in a territory provided that brand was not already serviced by another wine wholesaler in September, 1996. Plainly, Appellant National Wine & Spirits, L.L.C. can also purchase an already-existing wholesaler's business and sell its brands. That is, Appellant National Wine & Spirits, L.L.C. is merely prohibited from being assigned to sell a brand of wine if that brand was being sold by a non-ADA wholesaler in a particular geographic area on or before September 24, 1996.[23]

As recognized by both lower courts, the Legislature struck what it considered to be a fair and reasonable balance in how it wanted to structure Michigan's alcohol distribution system for spirits and wine. The Legislature put limitations on the ability of everyone who wanted to be both an ADA and a wine wholesaler to be dualed in order to continue to have a viable three-tier distribution system for wine. The Legislature decided to "grandfather" in only pre-existing distribution rights for specific brands in specific geographic areas. In fact, the September 24, 1996 date was rationally chosen to ensure that the pre-ADA status quo was maintained and to stop all who wanted to be ADAs from defeating the legislative purpose behind enactment of Section 205(3) by being "dualed" before the effective date of Section 205(3). Clearly, that legislative decision is rationally related to a legitimate state interest – whether or not Appellants agree with that Legislative decision. Again, as the legislature intended, this restriction primarily affected existing in-state wholesalers who wanted to become ADAs rather than out-of-state entities who wanted to become ADAs.

[23] In the Affidavit of Steve Null submitted by Appellants, Mr. Null seems to imply at paragraph 6 that all wine brands being **currently** sold in Michigan were already assigned prior to September 24, 1996. That is simply wrong and new brands have been introduced into Michigan since that date. See the affidavit of Julie Wendt, Director of Licensing for the Michigan Liquor Control Commission, which was submitted to the circuit court and is attached as Exhibit F.

CONCLUSION

Appellants' application should be denied. It is premised on the erroneous contention that Section 205(3) of the Liquor Control Code facially discriminates against interstate commerce, when it does no such thing. The statute does not discriminate on its face or in its application, as is evidenced by the fact that Appellants are currently both a wholesaler and an ADA.

Appellants erroneously claim that a Sixth Circuit Court of Appeals decision (*Heald),* where Michigan's Petition for Writ of Certiorari was granted by the United States Supreme Court on May 24, 2004, mandates reversal. That opinion is easily distinguished from the facts of this case and *Heald* itself is inconsistent with controlling U.S. Supreme Court authority, other Federal Circuit Court decisions (including the most recent decision to address the same issue as addressed in *Heald*), and the Webb-Kenyon Act.

Nor does the challenged statute violate the Equal Protection Clause. As both the circuit court and Court of Appeals recognized, it is well established that the states have an interest in structuring the distribution of alcoholic beverages -- as is evidenced by the fact that alcohol is the only product referred to in both the U.S. Constitution and Michigan Constitution. Section 205(3) is rationally related to accomplish the State goal of privatization -- the distribution of spirits -- without destroying the three-tier distribution system for wine. Section 205(3) is a legitimate legislative effort to ensure that the State will have an effective distribution system consistent with

the regulatory scheme that has been in place since the repeal of Prohibition and which has served the State and its citizen's interests since that date.

Respectfully submitted,

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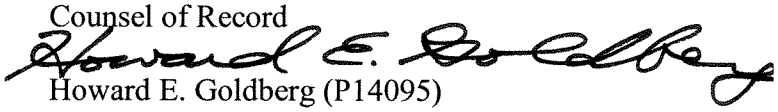

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